Project Agreement number 2022-1-MT01-KA220-ADU-000086969
Financial Skills foR busiNEss Startups Smes - FAIRNESS

MODULE No: 5

Responsible Partner: Malta Stock Exchange Institute

Title of the Module

Module Title	Module 5. ACCESS & USE OF COMPLEX FINANCIAL TOOLS & PRODUCTS Issue of equity and bonds on the capital markets
EQF-Level	4
Duration	6 hours

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Unit 1 Title	**Introduction to equity and bond characteristics**
Learning objective	With the completion of this unit, the learners should be able to understand the importance of capital adequacy, key characteristics of equities and bonds, and to distinguish between the two in terms of types of capital, risk, obligations and attraction to investors.
Knowledge	The learners will be able to recognize and describe the main characteristics of equities and bonds, and will be able to list and explain some basic features and rights of a share and a bond holder.
Skills	She / he will be able to understand the consequences of issuing equities and bonds, and the process of how to issues these instruments as offers to the public. The learner will be able to have a good knowledge of how these instruments operate when issued and the regulations that allow these to be passported across the EU.
Competence	She / he will have the competence to choose appropriate source of capital, and understand the consequences of issuing debt or equity on the market in order to manage the company's capital adequacy and sustainability.
Further information	Useful links may found at the end of this module.

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Unit 2 Title	**The prerequisites and the process to apply to the regulatory listing authority for the sale of equity and bonds under the regulated capital market.**
Learning objective	By completion of this unit, the learners will get acquainted with the need to have good corporate governance and the process to apply for approval to issue financial instruments on the capital market. The learners will also have a good overview of capital market processes required to be able to tap the capital market.
Knowledge	She / he will be aware of the principles of good corporate governance, the listing rules, and the requirements of issuing a prospectus in line with the directive. She / he will have a good knowledge of the advisers required to complete and issue the prospectus, and the process required to offer the instruments to the capital market.
Skills	The learner will be aware of the requirements and will be able to identify the processes and sources of advice and support in order to be compliant and eligible to seek to raise capital through the market
Competence	She / he can choose between the different alternatives available when considering raising capital through the market, and will be able to distinguish between the options based on effort required, and ongoing obligations, this being able to make the most effective possible decision.
Further information	Useful links may found at the end of this module.

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Unit 3 Title	**Continuing obligations to equity and bond investors**
Learning objective	The consequences of being a listed organisation can be onerous. The Board of directors need to maintain transparency standards, avoid insider trading and manage shareholder / bondholder expectations in order to maintain harmony and price stability / growth in the market place
Knowledge	She / he can understand market forces determining price, the obligations of the listed organisation to the market, and the key requirements of equities and bonds.
Skills	The learners will be able to assess the transparency requirements of the market, the obligations to the investors, and the options available to the issuer when it comes to repayment of the bond, and payment of dividends to shareholders.
Competence	She / he will have the capacity to select the most appropriate instrument to raise capital, and understand the consequences of each option.
Further information	Useful links may found at the end of this module.

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Unit 4 Title	**Branding and long-term costs / benefits of being a listed entity**
Learning objective	With the completion of this unit, the learners should be acquainted with the main benefits, costs, obligations and consequences of being a listed entity and raising capital through the market.
Knowledge	She / he can identify the branding benefits, and long term consequences of being a listed entity. These will include growth and brand loyalty, and the opportunity to access capital in the future.
Skills	The learners will understand the consequences and responsibilities / obligations that being listed entity places on the organisation.
Competence	The learners will be able to assess the viability of placing the entity on the market, and will understand the long term benefits and costs of this.
Further information	Useful links may found at the end of this module.

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Educational CONTENT for students/people to be trained:	
	Introduction:
Topic 1	Introduction to equity and bond characteristics
Topic 2	The prerequisites and the process to apply to the regulatory listing authority for the sale of equity and bonds under the regulated capital market
Topic 3	Continuing obligations to equity and bond investors
Topic 4	Branding and long-term benefits / costs of being a listed entity

Introduction

General Overview

The capital markets are a very useful and mostly cost-effective source of capital but which require an economy of scale that would make most SMEs unwilling or unable to tap into this market. Organisations may consider access to the SME oriented capital markets for smaller value issues, which require less of a financial investment and which could result in access to smaller values of new capital. In order to access the capital market, one needs to understand the different options available to the issuing organisation, the costs and the benefits, and the consequences that will apply before, during and after the process.

Successful access to the capital markets requires the engagement of a critical mass of investors, both retail and institutional, who are willing to invest their money in the organisation through the purchase of shares or bonds, in order for the issue to be deemed successfully subscribed. Admittedly, once successful, future issues will be easier and more cost effective since the organisation will be marketing new issues to an existing pool of investors.

Sourcing capital through the market can be very cost effective, especially for an already listed entity that is already compliant with the regulations and that already has a positive brand identity and profile.

Objectives of the Module

With the completion of this module, you should be able to understand the difference financial instruments available to issuers to raise capital, the process to access the market, and the obligations of the organisations once the issue is admitted to listing. The learner will understand and have competence in assessing the difference between issuing equity or a bond, and will be able to decide between these based on the dilution of shareholding, ongoing obligations, payment of returns to investors, repayment options as well as rollover opportunities in the case of bonds. The costs and benefits of being a listed entity should not be ignored and this module will help issuers to understand these, placing them in a better position to understand whether the capital market is a viable source of capital for them.

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Title of Topic 1

Introduction to equity and bond characteristics

Main point 1.1. Title

Introduction to equity and bond characteristics

1.1 Main Content

1.1 Key Terminologies and Definitions

A capital market is a financial market in which long-term debt (classed as debt instrument that are repayable with a term of over a year) or equity securities are traded in a regulated, transparent and secure manner.

The most common instruments traded are equities (also known as shares that indicate ownership of a company) and bonds which are debt instruments. Bonds could be corporate (issued by corporate entities) or sovereign (issued by government treasuries and which form part of the respective jurisdiction's national debt). These instruments would be offered to the public through an Initial Public Offering (IPO) for equities or an issue for bonds following the approval from the jurisdiction's national competent authority.

Capital markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments. Financial regulators like Bank of England (BoE) and the U.S. Securities and Exchange Commission (SEC), the Malta Financial Service Authority (MFSA) oversee capital markets to protect investors against fraud, among other duties.

Once the instruments are successfully sold to the public, they are then 'admitted to listing' allowing trades to take place on the market. These transactions are generally processed and managed by brokers authorised to trade on their respective market, who within the financial sector, the treasury departments of governments and corporations, but also may be accessed directly by the public. This depends on the jurisdiction's rules and practices, which may differ between jurisdictions.

Equities and bonds may be purchased in the primary market, from the issuers, during the offer period at fixed offer prices and at no additional cost to the purchaser. Subsequently, once they are admitted to trading on the secondary market, individuals, and entities such as investment houses, banks and fund managers may trade in shares and bonds in the secondary markets. The price of instruments is determined by supply and demand, which in turn can be the result of a large variety of market forces, developments as well as expectations. Secondary market trades may be subject to commissions and fees.

An equity is another word for shareholding. The shares form part of the capital of a company and represent the initial investment made by the shareholders in the company. Each share has a nominal value, and the total share capital in the company's balance sheet is the total number of shares issued multiplied by the nominal share value. Shares are usually fully paid up, but may be part paid (e.g., 50% of the nominal value). Investors in a company will own shares and will be deemed to have a controlling interest of the company is they own 50% of the issued shares plus 1. Shareholders may appoint a director on the Board to represent them – it should be stressed that directors represent all shareholders and not individual or shareholder group interests. Shares are not repayable but may be sold to third parties. Shareholders will be eligible to a dividend (distribution of profits) if this is declared by the Board of Directors during the Annual General Meeting which the shareholders may attend. Shareholders are the last to be paid in the event of a liquidation of the company.

A bond is a debt instrument that the company may issue to investors. Bonds are a debt and will normally have a repayment date (eg 10 years) and have a fixed coupon rate (interest rate, eg 4% p.a.) which will be paid to bondholders on fixed dates, usually twice a year. This is especially useful when market interest rates are low, and the issuing organisation may issue a bond at a relatively low coupon rate, which remains fixed even if market rates increase.

The nominal capital raised through the bond will be repaid in full on maturity. Interest paid by the company is a tax-deductible expense. Bondholders do not have any rights to attend the annual general meeting and have no influence on management. However, bondholders may have preference in respect of repayment in the event of liquidation of the company but will always rank above the shareholders. In this regard, bonds are deemed to be a less risky investment compared to shares. Bonds are traded between investors and may be bought back by the issuer company through the market.

1.2 Importance of capital adequacy and access to liquidity

A capital adequacy is the amount of capital an organisation needs to have as part of its asset base in order to finance operations and maintain adequate levels of liquidity. Banks or other financial institutions have to have levels of capital adequacy as required by their financial regulator.
Capital adequacy is usually expressed as a capital adequacy ratio of equity as a percentage of risk-weighted assets. Capital requirements govern the ratio of equity to debt, recorded on the liabilities and equity side of a firm's balance sheet. An organisation that has high levels of debt as compared to its equity is deemed to be highly geared, and will require relatively higher levels of turnover, cash generation and profitability in order to service the debt than lower geared companies. It should be stressed that capital is a source of funds not a use of funds.

Capital liquidity should not be confused with capital adequacy. Liquidity is more concerned with the assets side of a bank's balance sheet—in particular, the proportion of assets held in cash or other liquid assets. Liquid capital is the part of an organisation’s assets that is held as money and includes cash balances, bank deposits, and money market investments. Since these assets provide little or no income to the firm, it will ordinarily seek to invest them in activities that offer a higher return on investment, apply them to outstanding debts, or distribute them to the firm's owners. However, organisations need to ensure that they have adequate liquidity in order to pay their current obligations, so areas such as salaries, stock and creditors, and bank loans.

1.3 Complex and vanilla financial instruments

A plain ‘vanilla’ financial instrument is a basic, standard financial product that is widely available on the market and that has no features that could increase the level of risk exposure, or require the investor to have specialist understanding of the implications of these features. There are no frills, no extras, and are covered by plain simply defined terms. Examples of these could be a bond that has a fixed coupon and has defined maturity and interest payment dates. Predictably, the term ‘vanilla’ comes from the simplicity of the ice cream flavour that is uncomplicated and predictable. Vanilla instrument became more relevant after the financial crisis of 2008, in an effort to reduce the level of risk faced by retail ‘unsophisticated’ investors.
On the other hand, a complex instrument would have features that make these products unsuitable for

the retail market because of their complexity, volatility, or illiquidity, all of which make them more risky. Examples of complex instruments could be subordinated or convertible bonds, structured products, bonds with variable coupons or terms, or instruments that leveraged. All these factors make them more difficult to understand, and therefore more risky.

Because of the risks associated with the many different types of products, regulations ensure that a retail investor may only invest in a vanilla type of product, whereas one would need to be a professional investor or an institutional / qualified investor to invest in complex instruments.

1.4 Regulatory Framework - passporting across Europe

The European Union has regulations that allow the freedom of movement of good, people and capital across jurisdictions. The free movement of capital is ensured through the prospective directive which defines that an offer to the public needs to be approved by the jurisdiction's regulator on the basis of the prospectus that would be submitted by the issuing entity or his agent. The Prospectus would typically contain all relevant information about the issue, outlining the financial instrument on offer, the project or business, the risks, the terms, and the security, and which allow the prospective investor to take an informed decision. The key advantage of a prospectus is that once approved by the regulator, the issue may be 'passported' across the EU. The prospectus directive defines an 'offer to the public' to be an issue of at least €5 million or is sold to 150 investors or more.

1.5 The 'ingredients' making up the interest rate

The effective interest rate that is applied by a borrower or a lender will be a function of the following:

- The base interest rate. This is determined by the regulating body (in the EU, this is the European Central Bank. In the UK, this is the Bank of England, in the US, it's the Federal Reserve)
- The rate of inflation. This will affect the purchase power of money in the future, and therefore the effective interest rate will factor in the rate of inflation
- Risk. The lender (and conversely the borrower) will assess the risk of default, and this will have a direct effect on the effective interest rate applied
- Time. The duration of the investment / loan / deposit will influence the interest rate since the longer duration would need to be compensated for.
- Liquidity. The investor will need to be compensated in the event that the investment is illiquid, and the investor is effectively locked into the instrument.

Main Point 1.2 Title

The prerequisites and the process to apply to the regulatory listing authority for the offer for sale of equity and bonds under the regulated capital market

1.2. Main Content

2.1 Corporate Governance and compliance, adherence to the listing rules

The code of good corporate governance is enshrined in the Company's ACT and requires that all companies have the following four basic practices built into the decisions made by the board of directors and therefore also to company management and staff and that are at the heart of good corporate governance:

Accountability – this is defined as being responsible for one's actions, decisions, behaviour, and performance. It is linked to the being held responsible for achieving the organisational goals and making decisions that are in line with the achievement of these goals, without any personal biases or agendas.

Transparency – this is defined as being honest and open, and fully disclosing all relevant information so that there is total awareness and free communication, enabling others within the organisation are fully informed on developments and are able to take informed decisions.

Fairness – This implies that the organisation's management and staff apply themselves through adhering to a fair and impartial process, without hidden agendas or bias. This also implies that there will be mutual respect, strong interpersonal relationships and honest communication, combined with the absence of any forms of abuse or favouritism.

Responsibility – This implies that the individuals are assigned tasks and roles in line with their position within their organisation and which they are obliged to perform or which they may delegate without losing or abdication from their responsibility for the task or role.

These imply that the organisation is working with the right levels of integrity and lawfulness. Listed organisations in particular are bound by their regulator to ensure that the principles of good corporate governance are embedded within organisational policy, procedures and actual behaviour. They are also bound to have a compliance function within their organisation that will monitor and ensure adherence to regulations, and maintain the principles of good corporate governance.

2.2 Appointing the advisors – legal, finance, broker, sponsor. Creating the prospectus/ offering document

Seeking to raise capital, even below the prospectus directive threshold, will require approval by the responsible authority. This implies that the organisation is required to have the correct and sound legal structure, historical financial reporting and governance structures to ensure that the organisations is sustainable and that good governance is maintained before and after the capital is raised. The process also requires the services of a sponsor who would need to be appointed to create the offering document (or the prospectus) that would be used to apply to the market regulator for approval. The sponsor may also be the broker who would be responsible to bring the offer to the public and manage the application / registration process effectively. Sometimes, and in the case of small issues that di not require a prospectus, the sponsor may be called a corporate advisor. In any event, the sponsor / corporate advisor would rope in legal and financial services in order to assist in the compiling of the application document.

The prospectus / offering document would outline all the information required to enable the investor to take an informed decision about whether to invest, and would contain information such as:

- Definitions of the terms used in the prospectus.
- Information about the issuer

- Structure, ownership of the organisation, and the group structure showing the issuing company, and any other relevant parties within the group.
- Business overview and an outline of the lines of business that the issuer is involved in
- Information on who the directors and auditors of the issuer are.
- Information on the executive management, with a brief outline of their roles and experience in the organisation.
- Financial information on the issuer, which statements would be audited. The issuer may also have projected financial plans that would be relevant to the use of the capital being raised.
- Financial instruments being offered explaining their ranking, repayment and interest payment details (in the case of bonds)
- Security / guarantees that may be available to the investor
- The risks that the organisation faces, distinguishing between systematic and unsystematic risks and how the organisation is addressing these risks where possible.
- Use of funds that will be raised as a result of the issue. This could be business development, new projects, consolidation of debt through the repayment of current bank finance, research or new business ventures.
- Timetable of the issue showing when the offer will be open to applications by the public, the closing of the offer, the allocation and subsequent start of trading dates.

2.3 Application to the regulator for approval

The offering document is presented to the regulator in its entirety for consideration and approval. This process can be time consuming. In the event that the issue is being made under the Prospectus Directive, the application is made to the jurisdiction's Regulator. If it does not, then it would be made to the regulating body that is responsible for the smaller issues, usually called junior markets. This body would still be responsible to the Regulator and must abide by the market rules. Unregulated and private issues may also be made through a broker and it is the responsibility of the broker to assess the admission document which would be used to promote the private issue.

2.4 Post-approval process to issue offer to public

Once the issue is approved for offer to the public, the issuer and the sponsor/ broker team would offer the instruments to the investing public. This could be through a mass market campaign, which can be very expensive, or through a private placement made directly with the clients of the broker and his associates. This is by far the most cost effective means, but would depend on the size of the issue in order to be viable. The process would include a registrar who would collect the applications and the respective payment and manage the registration process until the offer is fully subscribed. In the event that it does not attract a minimum value of applications, the offer would be withdrawn and funds received would be refunded. Applications over the authorised offer value would also need to be refunded and an allocation policy would need to be established by the issuer.

2.5 Admission to listing

Once the offer is closed and fully subscribed, the investors would be notified, and their investment account (with the depository or their nominee) would be credited with the instruments. The issue would then be admitted to listing, usually with a two day notice. Trading on the exchange would be allowed after this point.

2.6 Appointment of the depository to manage the register

Admitted organisations must assign the responsibility of managing their shareholder or bondholder registers to the depository which needs to keep these registers up to date. This will apply both in respect of personal data, such as name address, tax status, as well as running balances of the instruments held post any trading that takes place on the secondary market. This data will be used by the organisation company secretary in order to communicate with the share / bond holders or to carry out any corporate actions.

TOPIC 3:

Title of Topic 3

Main point 3.1 Title

Continuing obligations to equity and bond investors

3.1 Main Content

3.1 **Continuing obligations – market information, avoidance of insider trading, financial reporting**

Listed organisations are obliged to maintain appropriate levels of transparency and should inform the public of any market sensitive developments through the issue of a company announcement. This could be the change of a member of its executive management, or some market development that is in the public domain and that may have an effect on the business.
Persons within the organisation who have access to key information and knowledge are precluded from using this information by taking advantage and trading on the basis of this 'insider knowledge'. For example, these persons are not allowed to trade on the market several months before the publication of the organisation's financial statements.
The financial reports of the organisation should be issued annually, within a set period after the close of the financial year (usually 4 months). These should be audited and easily available to the public. Some jurisdictions require that these are sent to all shareholders, in hard copy or in some cases electronically. Some jurisdictions require that abridged financial statements are also published after 6 months.
Organisations may use the electronic communications tool through the issue of company announcements in order to communicate with the market communications and effect any announcements such as the calling of a general meeting for shareholders (in the case of equity issues), changes in directors or executive management, or any other market sensitive information.

3.3 Market pricing and liquidity

Market price will be established based on supply and demand, each of which will depend on the market conditions, levels of confidence, the economic conditions, and the strength of the brand of the issued organisation. Market liquidity will also play an important part since investors who want to buy / sell an illiquid instrument may struggle to find a seller / buyer and this could affect the respective price. Equity issues will usually have 25% of the share capital available for trading, whereas bond issues are 100% in the public domain, and are therefore usually more liquid than equities.

3.5 Dividend policy vs reinvestment of earnings – Equities

Dividends are declared by the Board of Directors, after the publication of the financial statements, and are sourced from profits earned in the last period or from retained earnings. A dividend policy will rarely be declared since it can be seen as a commitment but will be declared depending on financial performance and cash availability. Dividends may also be declared in the form of new shares issues usually as a ratio to existing holdings, eg 1 new share for every 10 held. Organisations will usually prefer to hold on to earnings / cash which will be used for reinvestment and to avoid resorting to external sources of finance, where possible.

This is a trade-off against the shareholder's wish to receive a dividend. Dividends are paid to shareholders net of corporate tax that is deducted at source.
The issue of equity is seen as a benefit to the organisation since it is free capital. There is no obligation to pay dividends and the equity investment is not repayable. It does however result in the dilution of ownership for the original shareholders and could result in small shareholder interests and representation on the board of directors. It is also not a tax-deductible cost since any dividends issued are paid from retained earnings which are already net of any corporate tax paid on profits.

3.6 Payment of interest and capital – rolling over – Bonds

Bond issuers need to ensure that they have adequate cash generation from operations in order to pay the interest obligations annually. They also need to ensure that they are increasing liquidity over the term of the bond in order to repay the capital when due. Some organisations opt to issue a new bond just before the maturity date in order to use the proceeds of the bond to repay the investors in the maturing bond. Much will depend on the strength of the brand, its gearing ratio and financial performance/ balance sheet strength, and the prevalent market interest rates that will make this option viable.
The issue of bonds could be seen as a benefit to the organisation since the source of capital is usually unsecured, and does not dilute shareholding. The interest paid is deducted from income, so there is an element of tax efficiency. The organisation must cater for the interest payable from cash earning, and must also plan for the eventual repayment of the bond.

3.7 Advantages and disadvantages of investing in equity

Equities are a long-term investment that have potential for significant capital appreciation. They also are eligible to a dividend return. The purchase process is fairly easy on the secondary market but may suffer from market liquidity issues. Purchase at the IPO phase is more cost effective than through the secondary market. Tax on dividend income is paid at source, and capital gains may be subject to tax, depending on the jurisdiction. Equity owners may attend and vote during the organisation's Annual General Meeting.
They do give the investor a high level of risk and tend to suffer through price fluctuations. Dividend policy and organizational results are subject to the Board's policies and the market price may also be impacted by the business / economic cycle sensitivity. The asset may be used as collateral, but this is probably at a high margin. Dividends are paid net of corporate tax, and any refunds from the Inland revenue would need to be claimed by the shareholder, if possible.

3.8 Advantages and disadvantages of investing in bonds

Bonds are a short to medium-term investment that give a regular and predictable return combined with a relatively stable market price, resulting in a medium to low-risk investment that may be secured. Purchase is usually more cost effective at the issue stage when compared to the secondary market, and binds are usually quite accessibility and liquid. The price is strongly influenced by changes in market interest rates.
Bonds usually pay a fixed rate of interest (coupon) which may be better than traditional 'bank' interest rates, and which are a benefit when the market interest rates are expected to decrease.
Bonds may be used a collateral that will be applied at a reasonable margin, and are a tax efficient vehicle with a final withholding tax being paid at source. As explained, bond issuers require a strong cash flow performance and need to prepare for the final payment upon maturity.

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Main point 4 Title

Branding and long-term costs / benefits of being a listed entity

4.0 Main Content

4.1 The power of branding

A listed organisation is likely to have a strong level of brand awareness and loyalty. The equity organisations also have a market valuation as a result of the prevalent market price. A strong brand will enable the issuer to tap into the market in the future, be it to raise new capital or to rollover a maturing bond. This potential to access the market in the future is very strong and may give entities access to cheaper and unsecured capital through new issues of bonds especially in low interest rate environments.

4.2 Credit assessments and independent rating agencies

A credit rating will have a strong effect on the risk profile of the organisation, and a positive credit rating will enable the issuer to raise capital at a lower coupon. Institutional investors will often require a credit rating in order to invest in these issues, however obtaining a credit rating from a reputable agency (Standard and Poors, Fitch or Moody's) can come at quite a significant price.

4.3 Access to capital

A listed organisation will not only enjoy the benefit of having access to the capital raised as a result of the admission to listing. The organisation, if it continues to remain compliant, well governed and viable, will build investor confidence, possibly increase its customer base, and be in a better position to communicate with the market. Some studies show that listed entities outperform unlisted 'private' entities since the quality standards of their decision making and management, transparency, business focus and levels of accountability are much higher, making them more efficient and effective in achieving and developing shareholder value.

4.4 Costs of being a listed entity

There are downsides in being a public listed entity. These include:

- The high marketing and PR costs required build the brand in order to support the new offer for sale of the equity or bonds to the public, as well as the ongoing communications with the market to retain positive brand recognition and perception.
- The running of a transparent entity implies more organisational and communication costs will be incurred.
- The standards of compliance are significantly higher, making the entity incur high compliance and regulatory costs when compared to a private one.
- The level of scrutiny on the operations and business practices of the organisation are higher, coming from regulatory organisations as well as the market. This could make decision making more cumbersome in trying to ensure maximum compliance and transparency.
- The Board of Directors may be faced with small shareholder issues resulting in time and resources expended on matters that are not necessarily adding shareholder value but more focused on managing shareholder relations.

4.5 Benefits of being a listed entity

A listed entity will enjoy

- Strong brand recognition and loyalty, through positive market communications and adherence to the listing obligations and returns to investors.
- The internal efficiency and decision-making benefits as a result of good governance standards and transparency obligations
- Efficient cash management as a result of planned and predictable payments
- Shareholder benefits through equity market valuations and access to liquidate shares,
- Independent directors and / or external advisors who will add value to the organisation's efficiency and growth potential.
- Use of different dividend options which may include payment of cash dividends but may also be the issue of bonus shares.
- Roll-over potential when the bond approaches maturity and the organisation may opt to issue a new bond to repay the maturing bond obligations
- Tax benefits through the tax deductible payment of interest on bonds
- Lower interest costs when compared to traditional sources, and fixed costs since bonds are usually issued with a fixed rate for the duration of the bond's life.

4.6 Industry Trends

Circa 65% of US organisations use capital markets as a source of capital, with 35% relying on bank finance. This is in contrast to Europe where 35% us capital markets and 65% use bank finance. This makes the US market much more liquid, but it should be noted that trends show that European capital markets are becoming more accessible, and investors are seeking to diversify their portfolios through investment in various asset classes.

Conclusion

The traditional sources of finance available to organisations will remain the banking sector which is geared towards providing short and medium term lines of credit which are usually secured by assets and which are repayable on demand (overdrafts) or through a planned repayment programme through which capital and interest are repaid through regular payments.

The capital markets are a very useful and generally cost-effective source of capital and can be a brand building and efficient source of finance. The process to access capital through the markets can be time consuming as well as resource hungry as a result of governance, compliance and transparency requirements.

Organisations wishing to access such capital may consider access through the Regulated Main Markets, or through specialised SME-oriented capital markets that are designed for smaller value issues and which require less of a financial investment and resources.

However, successful access to the capital markets through the engagement of a critical mass of retail and / or institutional investors can be very cost effective, done on the basis of confidence and not necessarily security provided, and once successful, makes future issues easier and even more cost effective since the organisation will be marketing new future issues to an existing pool of investors.

Sourcing capital through the market can be a very positive experience for the issuer as well as its brand since it is ensured to be compliant with the regulations and governance requirements resulting in a positive brand identity and profile.

Further reading

Resource name	Type	Link
Malta Stock Exchange website	Website	https://www.borzamalta.com.mt/
Regulated Main Market Listing Rules	Website	https://www.mfsa.mt/wp-content/uploads/2023/01/Full-Capital-Markets-Rules-as-amended-on-23-January-2023.pdf
Prospects MTF Admission rules	Website / pdf	https://cdn.borzamalta.com.mt/ProspectsMTF/Documents/Prospects%20MTF%20Rules.pdf
Financial instruments overview	Website	https://www.mfsa.mt/consumers/investments/financial-instruments/
Prospectus documents	Website	https://www.mfsa.mt/our-work/capital-markets-supervision/#CMS

Assessment quiz

Question 1.

The financial instruments available to be offered to the public through the capital market are:
Select the correct options from the following:

a. Bank loan
b. Mortgage (Home loan),
c. Equity (shareholding)
d. Fixed term certificate of deposit
e. Credit card,
f. Corporate Bond

Question 2.

True/ False quiz

Bonds are debt instruments that will normally have a repayment date (eg 10 years) and have a fixed coupon rate (interest rate, eg 4% p.a.) which will be paid to bondholders on fixed dates, usually twice a year.

True

False

Question 3:

Investment in equities implies:

Select the correct options from the following:

a. Ownership of the company
b. Eligibility to dividends declared
c. Repayment of the capital invested
d. Relatively high levels of risk
e. Risk free returns on investment
f. Potential for capital growth

Question 4:

The code of good corporate governance outlines the regulatory and compliance obligations of an organisation in order to ensure accountability, transparency, fairness and responsibility standards:

True

False

Question 5.

The Prospectus is a document that is approved by the regulator and contains the following information:

Select the correct options from the following:

a. An overview of the issuer's business
b. The market risks that are faced by the issuer
c. The guaranteed return on the investment being proposed
d. The planned use of funds being raised through the issue
e. The operational business plans of the issuer
f. The historical financial performance of the issuer

Question 6.

Dividends are paid by organisations to their shareholders. These could be described as:

Select the correct options from the following:

a. Cash payments made to investors in relation to the number of shares owned
b. A guaranteed rate of return to shareholders
c. Payment of funds sourced through retained earnings and profits
d. Issue of new equity to current shareholders financed from retained earnings or profits
e. A tax free return on investment

Question 7.

A credit assessment rating will determine:

Select the correct options from the following:

a. The default risk associated with the issuer
b. The level of risk premium that will apply to the issuer
c. The cash generation potential of the issuer
d. The markets where the issuer has a growth potential
e. The forecast of future cash generation and profitability

Question 8.

The costs of being a listed entity include:

Select the correct options from the following:

a. Compliance and governance with regulations
b. The market trading transaction fees
c. Marketing and PR to build and support the entity's brand image
d. Marketing and advertising of organisation products and services
e. Staff training to achieve exceptional quality standards

Question 9.

The benefits of being a listed entity include:

Select the correct options from the following:

a. Positive brand image as a result of good market performance
b. Efficiency due to transparency and good governance
c. Cost effective access to capital in the case of the issue of bonds
d. Shareholder access to operational management issues
e. Guaranteed return on investment
f. Potential to further access to capital in the future

True/ False quiz

Question 10.

The capital markets are a very useful and mostly cost-effective source of capital that could result in long term benefits and returns to the issuing entity as well as the investor

True

False